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SUBJECT: TURKISH REAL SECTOR BEING SQUEEZED FROM ALL SIDES

REF: A. ANKARA 1920

[1](#)B. ANKARA 1829

[1](#)C. ANKARA 1744

Classified By: Economic Counselor Dale Eppler for reasons 1.4 (b) and (d)

This is a joint cable prepared by Embassy Ankara and
Consulate General Istanbul.

[1](#)1. (SBU) Summary: With the financial crisis hitting both Turkey and the region, the real sector finds itself squeezed between a sharp economic slowdown in key export markets and a tightening of credit. With \$191 billion in FX debt (combined real and financial sector) outstanding, Turkey's private sector is feeling very exposed. Macroeconomic indicators continue to deteriorate. GDP growth projections are being cut, with some private analysts now predicting negative GDP growth for 2009 (versus 4% growth in the 2009 budget), and inflation is expected to rise. The devalued lira makes exports more competitive, but there are few foreign buyers and very little export financing. Banks are slowing or cutting off lending and even asking all but the best customers to repay loans early. Heavy foreign exchange debt in the real and financial sectors means many companies will have difficulty either rolling over this debt or finding enough FX in the domestic market to repay, particularly non-export sectors like construction and real estate. Plants are closing and 65% of Turkish companies surveyed say they are cutting planned investment. Realizing that the GOT cannot do anything about recession in Europe, the real sector is pushing hard for GOT action to ease the credit squeeze, including repeated calls for a new IMF program or other FX financing mechanism. Even with immediate GOT action, the likely outcome will be sharply higher unemployment in 2009, a

volatile political and social problem in Turkey, with 50% of the population under age 25 and more than 18% of those unemployed. End summary.

Macro Background

[1](#)2. (U) Turkish macroeconomic indicators and expectations continue to deteriorate. GDP growth projections for 2008 and 2009 are being slashed and then slashed again. The European Commission now estimates 2008 growth will slow to 2.7%, while private analysts are predicting rates down close to 2%. The 2009 budget (submitted to Parliament October 17) assumes 4% GDP growth in 2009, while private predictions range from a high of 1.5% down to a loss of 1.2%. Industrial production fell 5.5% in September, the sharpest decline in six years. Recovery will not be easy given adverse demand conditions abroad and at home, and the slowdown in growth seems to be

persistent. On November 13, Standard and Poor,s downgraded Turkey,s credit outlook from stable to negative.

13. (U) Capital outflows in October prompted a sharp depreciation of the lira. Although the lira rebounded from its low of 1.70 versus the dollar in late October, markets now expect further depreciation to 1.80 in the short term. The sharp lira devaluation did not help Turkish producers much because it was accompanied by continued economic slowdown overseas. Exporters who were demanding relief from the high lira only a few months ago are now scrambling to find buyers for their lower cost goods, and worrying about repaying FX loans. Most Turkish production uses imported inputs, which reduces the cost advantage from devaluation but ensures that devaluation will add to inflation. Inflation expectations in the latest Central Bank survey worsened on all time horizons: year end (13.8%), 12 months ahead (9.23%), and 24 months ahead (12.5%).

Private Sector Calls for GOT Action

14. (C) The Turkish real sector was facing difficulties going into the financial crisis due to high labor costs, rising utility rates, the strong lira and tough competition both at home and in export markets. The GOT,s labor market reform (see Ankara 1014) was revised to help address some of the real sector,s complaints.

15. (C) The Union of Chambers of Commerce and Industry (TOBB) and the Bankers' Association held a November 7 closed meeting to discuss sectoral problems caused by the global environment. TOBB President Rifat Hisarciklioglu said the banking and real sectors cannot survive without each other. Both sides agreed that even if there is no structural problem in the banking sector now, foreign resources for Turkish banks and the private sector are decreasing significantly. TOBB points out that Turkish companies should not assume there is financing available from Gulf countries, since falling oil prices limit their capacity to lend. Europe, Turkey's largest trading partner, is clearly in a recession. Small and medium companies need more help than ever and are finding ever fewer sources for that help. TOBB estimates that Turkey will need \$50 billion in financing to be able to reach the 4% rate targeted in the 2009 budget. TOBB and the Bankers' Association state that an IMF program is needed urgently not only for meeting Turkey's financing needs, but also to help manage investors' risk perceptions.

16. (SBU) After their closed meeting, TOBB and the Bankers' Association made a series of recommendations to the GOT: outside funding should be found as soon as possible. IMF and G-20 funds could be tapped and the G-20 Summit should be turned into an opportunity to find possible support programs for Turkey; Export-Import bank funds should be increased to support exports; monetary discipline should be maintained to avoid cash outflow and protect the image of Turkey as a safe haven; the 4% growth target is not feasible anymore. Preparations should be made for controlled contraction; and funds accumulated in the Unemployment Insurance fund should be used to avoid further job losses.

17. (C) Istanbul Chamber of Industry (ISO) Chairman, Tanil Kucuk, told us November 7 that the Prime Minister does not understand how serious the current problems are for the real sector, especially for manufacturers. Deputy Prime Minister for Economic Affairs Nazim Ekren held two meetings with various business groups including ISO, and he told business leaders the government "was studying the problem closely." A frustrated Kucuk said the GOT needs to stop studying and start acting. He tried to explain to Ekren that the GOT needs to generate FX liquidity for the real sector, because problems in the U.S. and EU have caused foreign credit to dry up or diverted it to other markets. Kucuk said a GOT guarantee on savings would be a real help. He said in the absence of a substantial guarantee, the public holds its savings in gold or in mattresses rather than in banks, or deposits its money in European banks where there is a 100%

guarantee. A GOT guarantee for bank savings would help solve this problem.

Credit Tightening at Home and Abroad

¶18. (U) The CBRT's September 2008 Bank Loans Tendency Survey showed that Turkish banks have tightened lending since the beginning of 2008 for all but the very best customers. Average interest margins, fees, and commissions for loans are rising rapidly. Conditions for housing and car loans are becoming especially stringent due to a perceived drop in consumer creditworthiness, but business lending also is tightening. According to a TOBB survey of its members, 50% of Turkish companies have been pressured by banks to repay loans early.

¶19. (U) Consumers as well as corporate borrowers are feeling the pinch. On November 11, Automotive Distributors Association President Ibrahim Aybar said banks are not approving many car loans, and he estimated that 75% of applications are declined by banks. According to CBRT data, the number of customers having trouble repaying credit card and retail loans increased 41.2% in September, to a total of one million customers with payment problems. ISO Chairman Kucuk told us Turkish consumers owe approximately 70 billion YTL (\$43.8 billion) in consumer credit "10 billion YTL of this is credit card borrowing, while the remainder is mortgage borrowing, car loans, revolving credit lines, etc." As the real sector contracts and unemployment increases, this level of indebtedness will become more problematic.

¶10. (SBU) Turkey's persistently high interest rates (the Central bank policy rate is 16.75%) induced many private firms to borrow in dollars or euro to take advantage of significantly lower interest rates. However, when the lira depreciated rapidly, loan terms that had been attractive became completely unaffordable. CBRT Vice Governor Erdem Basci told us non-exporting companies had taken out \$37 billion in foreign loans through foreign branches of Turkish banks. Since these companies do not have access to incoming foreign-denominated profits, Basci classified their foreign exchange repayments as risky.

¶11. (U) EFG Securities Chief Economist Baturalp Candemir told us that Turkish companies with FX debt lost approximately \$15-16 billion when the lira dropped from 1.20 to the dollar to 1.50. Companies are recording losses now, but repayments schedules are not too bad, he noted. Manufacturers have \$10-11 billion in loans coming due between now and July 2009; however, exchange rate losses in this sector will be at least partly offset by export receivables. The services sector is in much worse shape, he cautioned, with \$15 billion in repayments in the same period and no exports to shield it from exchange rate losses. Candemir estimated outstanding foreign currency denominated debt by sector as follows: construction \$2.4 billion; telecom \$2 billion; real estate \$4.8 billion, and tourism \$2.5 billion. Tourism is somewhat sheltered, but the industry will still suffer as Europe and Russia are affected by the ongoing crisis.

Investment Plans on Hold

¶12. (SBU) On October 30, IFC Regional Manager for Infrastructure Morgan Landy told a visiting USG group that the Turkish corporate sector is already feeling the heat from the global credit contraction. He expects the real sector to be hurt more significantly than the banking sector by the crisis. According to Landy, major investments requiring outside financing have been put on hold. Those moving ahead are using internal resources rather than seeking outside financing. Echoing these comments, TOBB told us that 65% of companies suspended their investment plans for 2009.

¶13. (U) Several major projects have been halted or called

off due to credit conditions. On November 5, Yapi Kredi Bank halted its REIT share sales due to the current unfavorable market conditions. Yapi Kredi also halted the sale of shares in its insurance arm, Yapi Kredi Sigorta, the last week of October for the same reason. The CEO of Global Holding said he would not be able to complete the privatization of Baskent Gaz because banks that had agreed to finance its \$1.61 billion bid in March decided they would not be able to lend money to the consortium before the end of the year. Zaman reported that the Turkish military would delay or cut some procurement projects because of the depreciation in the lira.

November 13, Hurriyet reported that two textile factories have closed down in the Adana Industrial Zone and about 50 companies there are furloughing their workers on annual leave. Sonmez Filament, operating in Bursa since 1972, temporarily halted production in August citing negative market conditions. "Since then no improvement in market conditions has been registered and the impact of the global crisis has increased market uncertainty further" the company said in a November 6 statement to the Istanbul Stock Exchange.

¶14. (C) Comment: Even with fast and renewed GOT efforts to aid the real sector, the most likely outcome of this export and credit squeeze is sharply higher unemployment, particularly for young workers. This could be a volatile political and social problem for Turkey, where about 50% of the population is under age 25, and youth unemployment is already over 18% versus 9.4% for the population overall.

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